

THE REPUBLIC OF UGANDA
IN THE TAX APPEALS TRIBUNAL AT KAMPALA
APPLICATION NO.41 OF 2023

ESRI EASTERN AFRICA LIMITED.....APPLICANT

VERSUS

UGANDA REVENUE AUTHORITY.....RESPONDENT

BEFORE: MS. CRYSTAL KABAJWARA, MR. SIRAJ ALI, MS. GRACE SAFI

RULING

This ruling is in respect of a withholding tax assessment of Shs. 103,630,170 made in respect to payments made to a non-resident person.

1. Background Facts

The Applicant is a branch of a foreign company that is incorporated in Kenya. The Applicant is the authorised distributor of ESRI Arc GIS Software ("the software") which is owned by an entity called Environmental Systems Research Institute (Esri), Inc, based in United states ("Esri Inc" or "the developer").

On 12 September 2022, the Respondent issued the Applicant with an administrative additional assessment for withholding tax amounting to Shs. 103,630,170 for the period of 01/09/2020 to 30/09/2020. The assessment was based on undeclared withholding tax on payments of Shs. 690,867,805 made to ESRI Inc, the developer. On 30 November 2022, the Applicant objected to assessment and 13 February 2023 the Respondent issued its objection decision disallowing the objection.

2. The issues for determination

The issue for determination is whether the Applicant is liable to pay the tax assessed.

3. Representation

The Applicant was represented by Mr. Timothy Lugaizi while the Respondent by Mr. Tony Kalungi and Ms. Sheeba Tayahwe.

Ms. Judy Munyu-Mwendia the Chief Financial officer of the Applicant in her witness statement stated that the Applicant markets and sells licenses to use the software to third parties in Uganda. The payment for the software is made to the Applicants bank account after issuance of an invoice by the Applicant to the end customers. The Applicant then pays the developer after deducting its commission. Following the payment, the developer grants the third parties a license to use the software remotely without any physical exchange of the software through the Applicant.

Ms. Judy Munyu- Mwendia also testified that the Applicant is not the provider of the software and is merely a marketing company that earns a commission in exchange for its marketing services.

During cross examination, Ms. Judy Munyu-Mwendia confirmed that that the Applicant is the sole distributor of the software in the East African Region. She also confirmed that the invoicing arrangements between the parties are such that Esri Inc., the developer invoices the Applicant for the software. The invoice however, bears the client's name as the license will be given to the client and not the Applicant.

Ms. Bride Nabibaasa, an officer in the Domestic Taxes Department of the Respondent, stated in her witness statement that upon review of the Applicant's objection, the Respondent discovered that Esri Inc. is an American based entity providing software services.

Ms. Bride Nabibaasa stated that Esri Kenya executed a distributorship agreement with Esri Inc. The Applicant, who is a branch of Esri Kenya, is the distributor of Esri Inc's software in Uganda. Under the agreement, the Applicant markets and executes agreements with Ugandan Customers and collects payments from them, which it in turn remits to Esri Inc. In the audit period, the Applicant remitted Shs. 690,867,806 and did not withhold tax from the remittance as required by law.

4. The Submissions of the Applicant

In their submission, the Applicant stated that they market and sell software to third parties in Uganda who pay Esri Inc. for a license to access the software. The payment for the software is made to the Applicant on their bank account held in Uganda after issuance of an invoice by the Applicant to third party customers. The Applicant then pays the developer after deducting its commission.

The Applicant submitted that they were assessed withholding tax under cited Section 85 of the Income Tax Act (ITA) (now section 84 and hereinafter referred to as such) which provides:

"1) Subject to this Act, a tax is imposed on every non-resident person deriving income under a Ugandan-source services contract.

...

3) Subsection (1) does not apply to royalty or management charge charged to tax under Section 83

4) In this Section, "Ugandan-source services contract" means a contract, other than an employment contract, under which - (a) the principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda".

The Applicant submitted that their interpretation of the above provision is that for the Developer to be liable to withholding tax, they must have sourced their income from a services contract in Uganda. Therefore, there must be a contract under which the developer provides services to a Ugandan resident and then receives payment / income from the services.

The Applicant argued that there are two contracts in the present case, namely:

- (i) A distributorship agreement between the Applicant and the Developer, and
- (ii) A contract between the Applicant and the end users in Uganda, who purchase a license to use the software.

With regard to the first contract, the Applicant submitted that it is the Applicant who earns income from Ugandan sources and not the non-resident developer. Therefore, section 84 does not apply.

In relation to the second contract, the Applicant submitted that the said payment is for a license to use software, which amounts to a royalty in accordance with section 2 of the ITA. As section 84 (3) exempts a royalty payment from withholding tax under section 84, the Applicant is not liable to withhold tax on the payments made to the Developer.

5. The Submissions of the Respondent

In reply, the Respondent submitted that the tax in dispute herein was charged under Section 84 of the Income Tax Act which states that;

"(1) Subject to this Act, a tax is imposed on every non-resident person deriving income under a Ugandan source service contract.

(2) The tax payable by a non-resident person under this section is calculated by applying the rate prescribed in Part V of schedule 4 to this Act to the gross amount of any payment to a resident under a Ugandan Source Services Contract".

The Respondent submitted that that the above elements are all present in the instant case as Esri Inc. is a non-resident person for Ugandan income tax purposes.

The Respondent submitted that AWI states in paragraphs 3 and 10 of her witness statement that the Applicant remits the payments received for the software, to Esri Inc. after deducting its commission. The remittances are evidenced in the Applicant's NCBA Bank statements which show the Applicant making payments to Esri Kenya for onward transmission to Esri Inc.

The Respondent cited Section 84 (4) of the ITA which states:

"In this section, "Ugandan Source Services Contract" means a contract, other than an employment contract under which-

a) The principal purpose of the contract is the performance of services which gives rise to

income sourced in Uganda and

b) Any goods supplied are only incidental to that purpose".

The Respondent submitted that **Black's Law dictionary 11th Edition at page 837** goods is defined as- "*Tangible or movable personal property other than money*".

A service is defined on page 1643 of the same dictionary as "*an intangible commodity in the form of human effort, such as labour, skill or advice.*"

The Respondent submitted that Esri Kenya, of which the Applicant is a branch, executed an agreement with Esri Inc. under which it assumed the role of distributor of Esri Inc.'s software in Kenya, Tanzania, Uganda, Ethiopia, Eritrea and Djibouti. The Applicant is the sole distributor of Esri Inc.'s software in Uganda. Its primary obligation is "to market, promote and support the distribution and use of Esri Inc.'s software in Uganda.

The Respondent submitted that the Applicant executes agreements with end users (Ugandan Customers), bills them, collects payments and remits the money to Esri Inc. The software can be a service or a good depending on the construction of the agreement governing the transaction. There is no such unique categorization as intangible intellectual property.

The Respondent submitted that the categorization of software was considered in the case of ***Africa Broadcasting (U) Limited Versus Uganda Revenue Authority App No. 44 of 2018***. This Tribunal considered whether or not software was a good or service. The Tribunal found that once intellectual property/software is on a medium, it is treated as goods. According to the Tribunal, while software is intangible intellectual property, once it is encoded onto physical media like DVDs, it is treated as tangible goods. However, whether or not a transaction involves a supply of goods or services depends on what is being sold. Where the subject matter is the sale of the software on for example a hard drive, tape etc., there would be a supply of goods. This is because it involves transferring the physical medium and the data it contains. Where the transaction involves issuance of a license to use software, there would be a supply of a service. This is because licenses merely confer rights but not ownership of the intellectual property itself.

The Respondent submitted that Esri Inc. gives the Applicant/end-users rights but not ownership of its software. Basing on *Africa Broadcasting (U) Limited Versus Uganda Revenue Authority (supra)*, there is a supply of services between the Applicant and Esri Inc., thereby bringing the contract within the ambit of Section 84 of the Income Tax Act.

The Respondent submitted that the Applicant alludes to agreements between the Applicant and end users of the software. However, these agreements have not been adduced in evidence and did not form the basis of the assessment of the tax in dispute herein nor were they adduced at objection level. The Respondent prayed that the same be disregarded by the Tribunal.

Whether royalties are exempt from WHT Under Section 84(3) (Formerly Section 85 (3)) of the Income Tax Act.

The Respondent submitted that Section 84(3) of the ITA provides:

"Subsection (1) does not apply to royalty or management charge charged to tax under Section 82".

Section 82 of the Income Tax Act states;

"1) Subject to this Act, a tax is imposed on every non-resident person who derives any dividend, interest, royalty, rent, natural resource payment, agency fee in case of Islamic financial business, or management charge from sources in Uganda.

2) The tax payable by a non-resident person under this section is calculated by applying the rate prescribed in Part V of schedule 4 to this Act to the gross amount of any dividend, interest, royalty, rent, natural resource payment, agency fee in case of Islamic financial business, or management charge derived by a non-resident person."

The Respondent submitted that Section 84 (3) of the ITA does not exempt royalty payments from WHT. The section states that royalty payments are not subject to WHT under Section 84 if they are charged under Section 82 of the Income Tax Act.

The Respondent argued that in the present case, the Applicant has not proved that it withheld any taxes under section 82 of the ITA. Therefore, the Applicant has not proved any entitlement to exemption.

The Respondent submitted that the tax rate under both Sections 84 (2) and 82 (2) is 15%. Even if Section 84(3) and Section 82 of the ITA was found to be applicable section to the transaction between the Applicant and Esri Inc., the Applicant would still be liable to pay the tax assessed.

The Respondent maintained that the income earned is paid to Esri Inc. by the Applicant and the Applicant was under an obligation to withhold tax on the payments. The Applicant is liable to pay the tax as assessed. The Respondent prayed that the Tribunal dismisses the application with costs to the Respondent.

6. Applicant's Submissions in Rejoinder

In rejoinder, the Applicant submitted that Section 84 (4) (a) of the ITA provides as follows:

"(4) In this Section, "Ugandan-source services contract" means a contract, other than an employment contract, under which- (a) the principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda".

The Applicant submitted that the services performed by the non-resident must give rise to income sourced in Uganda. The WHT cannot be said to apply to that transaction because the Developer is not the one that provides the services that give rise to income.

The Applicant submitted that Section 84 (3) of the ITA provides as follows: *"Subsection (1) does not apply to a royalty or management charge charged to tax under Section 82."* Section 84 (1) does not apply to royalty payments made to non-residents because such payments are catered for under Section 82.

The Applicant submitted that the Respondent stated that both Sections 82 and 84 provide the same 15% tax rate on income earned by a non-resident, so it does not matter under which provision the Applicant is found liable. It is the responsibility of the Respondent to

assess tax under the correct provision of the law so that the Applicant has the option to either concede to it or challenge it.

The Applicant contended that the Tribunal ought not to take an unconstitutional approach proposed by the Respondent of imposing a tax under Section 82 yet the assessment in dispute was raised under Section 85 (now Section 84) of the ITA. The Applicant maintained that it is not liable for the withholding tax assessed under Section 85 [now Section 84] of the ITA. The Applicant prayed that this application is granted with costs to the Applicant.

7. Determination by the Tribunal

Having read submissions of both parties, this is the decision of the Tribunal

The Applicant is the registered branch of a company that is incorporated in Kenya. It is the official distributor of Esri ArcGIS software in Easter Africa Region. The Software is owned by Environmental Systems Research Institute Inc based in USA ("Esri Inc." or "The Developer"). The Applicant markets and sells the software in Uganda to Ugandan customers. The Ugandan customers pay the Applicant, who remits the payment to Esri Kenay after they have deducted their commission. a

The Respondent issued a withholding tax assessment on the proceeds sent to Developer by the Applicant in the amount of Shs. 103,630,170. The Respondent imposed the tax basing on Section 84 of the ITA.

The Applicant argued that the transaction between them and the developer is outside the scope of withholding tax under section 84 as the Developer did not perform a service under a Uganda source services contract. The Applicant further argued that the payment made to the Developer was a royalty payment within the meaning of section 2 of the ITA. The Applicant stated that section 84 (3) exempts royalty payments from withholding tax that would ordinarily be imposed under the said section.

The Respondent's position is that the withholding tax was correctly assessed and is payable in accordance with section 84 of the ITA.

The issue to be resolved by the Tribunal is whether the Applicant should have withheld tax at a rate of 15% on the payments received from third parties (customers) and remitted to the Developer after deducting their commission.

The transaction

The first question that must be addressed is, what is the substance of the transaction? Based on the facts presented, there is no doubt that there is a non-resident person, namely Esri Inc, that is earning income from Uganda from the sale or provision of software to end customers in Uganda.

Whether this is done through a distributor or an agent or otherwise is inconsequential.

Having established the substance of the transaction, the next step is to determine the tax implications of the provision of software by a non-resident person to customers in Uganda.

As the parties have disagreed on the interpretation of section 84 of the ITA to the transaction, we shall now proceed to determine the application of the contested provision to the facts.

Application of Section 84

Section 84 of the ITA imposes withholding tax on every non-resident person deriving income under a Ugandan source services contract.

There are two conditions that must be met for a non-resident person to be taxable under section 84:

- (i) The non-resident must be deriving income from Uganda;
- (ii) The income should be derived under a Uganda sources services contract.

The first condition is satisfied as the Esri Inc, is deriving income from Uganda by way of license fees paid to it by the Applicant. This is evidenced by remittances made by the Applicant to Esri Kenya for onward transmission to Esri Inc. (See REX 7 at pages 39 to 66 of the Respondent's Trial Bundle).

The second condition is whether the income is derived under a Ugandan source services contract.

A Ugandan source services contract is defined by section 84 (4) to mean a contract, other than an employment contract whose principal purpose of the contract is the performance of services which gives rise to income sourced in Uganda. This means that there must be:

- (i) A contract
- (ii) whose principal purpose/ aim/ objective is the performance of services, and
- (iii) the above must give rise to income sourced in Uganda.

In the present case, there is:

- a) A distributorship contract between Esri Inc and the Applicant. The contract authorises the Applicant to distribute software in Uganda and in exchange, the Applicant earns a commission and pays Esri Inc. license fees for each software that is distributed by it. During cross-examination, the Applicant's witness, Ms. Judy Mwendia explained that following the payment, the developer grants the end customer a license to use the software.
- b) A service that is performed involving the provision of software. We are guided by the decision in ***Apollo Hotel V URA, TAT App No. 68 of 2018***, where the Tribunal while relying on ***Metropolitan Life Limited v Commissioner for the South African Revenue Service A 232/2007*** defined a service as follows:

"Services' mean anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of good"

In this case, the Tribunal found that rights granted to the Applicant under the license agreement, namely the rights to use the Sheraton brand and system constituted services and not goods. Therefore, the license to use software constitutes a service and not a good.

The Applicant attempted to bifurcate the transaction into two parts – the distributorship and the sale of the software to end users. However, the transaction must be looked at as a whole and when evaluated as such, there is performance of services, aided by the Applicant, in Uganda.

- c) Income sourced in Uganda. Section 78 of the ITA lists various ways in which a non-resident person will be deemed to have sourced income from Uganda. One of these is section 78 (c) which provides that income is derived from sources in Uganda to the extent to which it is a fee for the provision of services paid by a resident person. In the present case, the license fees are paid by the end customers in Uganda for the use of the software. As explained above, the software is a service and not a good. With regard to the payment, the Applicant acts a collecting agent whereby they collect the license fees for onward remittance to Esri Inc., the Developer, less their commission. Therefore, Esri Inc. sourced income from Uganda on account of the license fees paid by Ugandan customers to it for the provision of software services.

Consequently, the transaction in question has met all the conditions that must be satisfied for a non-resident person to be taxable under section 84 of the ITA.

Royalties

Having established that the transaction is liable to withholding tax under section 84, there is no need for an analysis of section 82. Besides, the Applicant agrees that the software license fees are royalty payments that are taxable under section 82 of the ITA. Their only contention is that the Respondent did not proceed under section 82 and is precluded from relying on it to assess tax. It is not uncommon for a transaction to be taxable under more than one provision. Whilst section 82 is a specific provision, section 84 is a residual provision that is intended to catch transactions that are not specifically dealt with by the preceding provisions.


We agree with the Respondent's position that even if both provisions of the ITA are found to be applicable to the transaction, the Applicant would still be liable to pay the tax assessed.

Having found that the non-resident is liable to withholding tax on income earned from the provision of software to customers in Uganda, it was incumbent on the Applicant to withhold the said tax and remit the same to the Respondent. This is as per the provisions of section 137 of the ITA which requires any person making payment of the kind referred to in section 82,84 or 85 shall withhold from the payment the tax levied under the relevant section.

Further, section 142 of the ITA provides that a withholding agent who fails to withhold tax in is personally liable to pay to the Commissioner General the amount of tax which has not been withheld, but the withholding agent is entitled to recover this amount from the payee. Whilst withholding tax is a tax on the non-resident person, it is the duty of the payor to withhold the tax and remit it to the Respondent. Where the taxpayer does not withhold the tax, they are personally liable to pay it to the Respondent. However, it is upon them to claim the tax paid from the non-resident person who should have paid it in the first place.

Having found that the Applicant is liable to pay withholding tax on software license fees made to Esri Inc., this application is dismissed with costs to the Respondent.

Dated at Kampala this 10th day of October 2024.



CRYSTAL KABAJWARA
CHAIRPERSON



SIRAJ ALI
MEMBER



GRACE SAFI
MEMBER